SpiritBank

July 21, 2011

BY ELECTRONIC MAIL

Board of Governors of the Federal Reserve System
20th St. & Constitution Avenue, NW
Washington, DC 20551
Attn: Jennifer J. Johnson, Secretary
regs.comments@federalreserve.gov

Re: Proposed Rule to Establish Ability to Repay requirements for Mortgages as Mandated by Title XIV of the Dodd-Frank Wall Street Reform & Consumer Protection Act

Docket No. R-1417
Federal Register Vol. 76, No. 91
Wednesday May 11, 2011/Notice of Proposed Rule—"Ability to Repay"

Ladies and Gentlemen:

SpiritBank appreciates the opportunity to respond to the request by the Federal Reserve Board of Governors for public comment regarding the above referenced Notice of Proposed Rulemaking to amend Regulation Z (Truth in Lending, aka "TILA") per the mandates of statute established in Title XVI (14) of the Dodd-Frank ***Wall Street Reform and Consumer Protection Act*** (hereafter Dodd-Frank, DFA or "the Act"). The proposed rule would implement DFA mandated sections to amend Regulation Z and prohibit creditors from making mortgage loans without taking into consideration a borrower's ability to repay the loan (hereafter ability to repay is noted as "ATR").

We believe that our role as a major home lender in Oklahoma through our retail branches as well as our presence through our Wholesale Secondary Conduit, American Southwest Mortgage Company, gives us the credibility and unique perspective on the impacts to housing finance and by extension, the general economy, that regulations promulgated under DFA will have and are already having even today.

For over 95 years SpiritBank has served its local communities as a source of financing for consumers wishing to purchase a home as well as refinance be it to lower their interest rate, shorten their term or utilize equity in the property. Like most community banks, SpiritBank believes that prudent and sound underwriting guidelines are the hallmark of sound lending. It goes without saying that a borrower's ability to repay a loan must be considered as the top priority in the determination of the borrower's creditworthiness.

Our comment letter is divided into the following sections:

I. Summary of Remarks on the Proposed Rule
II. Background and Market Presence of SpiritBank
III. Background to the Proposed Rule (Title 14 of Dodd-Frank Act)
IV. Commentary addressing specific requests for comments by the Board
V. Concluding Remarks

Again, we appreciate the opportunity to provide this feedback and commentary to the Board on what is undoubtedly one of the most important and fundamental regulatory changes to impact housing finance and home lending in the past three decades.

I remain—

Cordially,

Bruce W. Schultz
Vice-President, Mortgage
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Summary of Remarks

We would preface our remarks by simply stating that the ability to repay a loan has always been a fundamental benchmark standard in the panoramic spectrum of mortgage and loan underwriting criteria for Community and Commercial Bank lenders such as SpiritBank. The ability to repay is paramount among the numerous considerations for safety and soundness of any financial institution but especially so among banks such as ours. We do not take issue with the intellectual concepts and reasoning behind documenting and verifying a borrower's ability to repay any loan, especially a mortgage.

However, we stand with the multitude of our brethren in community banking across this nation in questioning the wisdom of mandating on such a microscopic level, the underwriting standards themselves and extending what has always been traditionally a safety & soundness issue—that of repayment ability—into one of consumer protection with the applicable penalties that apply for violations therein. Against this background we see a variety of problems arising with the Rule as proposed. Our main concerns follow the line of thought that such a rule will only lead to an unnecessary constriction of credit in housing markets as lenders attempt to comply with the requirements of yet another change in TILA.

We would further state that we are aware the Board is acting within the very strict confines of the legislation itself when drafting and constructing the Rule. We would like to explore that point somewhat further.

Section 1412—The Board's Discretionary Authority and Duty

While we appreciate the statutory burden the Board finds itself under from Title XIV of Dodd-Frank to promulgate rules governing ATR, we also would respectfully remind and encourage the Board to use the broad discretionary authority granted to it by Congress in Section 1412 of the Act where it reads, ***"The Board may prescribe regulations that revise, add to, or subtract from the criteria that define a qualified mortgage upon a finding that such regulations are necessary or proper to ensure that responsible, affordable, mortgage credit remains available to consumers in a manner consistent with the purposes of this section…"***[1]

We empathize with the fact that the Board has been given a very tedious task in determining this rule with very specific statutory language that Congress developed in Title XIV. It is very reasonable to understand the Board's rationale in drafting some of the language in the Rule that is proposed given what seems to be a narrow "channel" in which Congress gave the Board to navigate. That being said however we would also respectfully remind the Board of their duty to properly balance the improvement of underwriting quality with the avoidance of creating unnecessary restrictions in housing credit markets that would occur due to an overly narrow and restrictive rule. We believe that it is specifically for that reason, the balancing of competing interests that Congress granted the Board the very broad discretion in Section 1412 quoted above.

[1] Dodd Frank Act Section 1412 (3), (B), (i)

We believe the Congress included the very explicit granting of discretion found in Section 1412 for the specific purpose of allowing the Board, as the "experts", if you will, in economic matters to evaluate ATR and the Qualified Mortgage Safe Harbor (hereafter QM) in "the present day" reality of the national economy at the time of the rule's proposal (2011). A year has now passed since the passage of the Act and the economy remains mired in a painfully slow recovery. The Board is best qualified through its comprehensive level of market knowledge, combined regulatory experience and access to data to best evaluate the specific details of the QM in the context of present day economic reality as opposed to the context of the "past" when the QM was first drafted.

A mass contraction of credit availability to consumers will only serve to perpetuate the glut of housing inventory on the market and further prevent housing prices from finding a natural bottom from which to recover. This will serve only as "drag" on the economy and further the malaise our nation has found herself in since 2008. To prevent this we strongly encourage the Board to use that authority in creating a rule that is more transparent, less complex and thus easier to implement while still attaining the overall intent of Congress to improve underwriting quality through the doctrine of ATR.

We also pause to take notice of the vital importance that the QM will play in mortgage lending for the foreseeable future as it defines the "outer boundary" of the Qualified Residential Mortgage (QRM) exemption to the Credit Risk Retention Rules authorized under Section 941 of the Act.[2]

With this backdrop in place we now turn to the issues we see arising from the Rule as it is presently being proposed.

Problematic Issues of the Rule as Proposed

First, we believe consumers will ultimately bear the increased costs that will be passed on to them created by the requirements of compliance with such an intricate and tedious regulation. The aforementioned "merging" of what is a traditional safety & soundness principle (ATR) into the consumer protection regimen of TILA is bound to create an atmosphere of uncertainty by lenders as they attempt to update technology and other system necessary to be in compliance with the rule. Furthermore, the highly punitive and harsh punishment meted out to lenders who are found to violate the ATR rule will naturally create a "flight" into the QM Safe Harbor which provides a more firm defense for the lender against a claim arising under TILA.

Second, we believe that the proposed rule will not result in greater consumer protection as intended but shall create an atmosphere of further credit tightening. We see this happening from the standpoint that there will be a natural regression of lenders to operate only within the confines of the QM Safe Harbor and thus many other borrowers not meeting the strict construction of the QM "Box" will find themselves forced out of credit markets altogether. In

[2] Dodd-Frank Act Section 941 (E), (4), (C) "Limitation on Definition" where it states that the agencies tasked with writing the Risk Retention rules and the QRM shall define QRM to "be no broader than the definition 'qualified mortgage' as the term is defined under section 129C(c)(2) of the Truth in Lending Act as amended by the Consumer Financial Protection Act of 2010, and regulations adopted thereunder."

fact, non-QM loans could begin to carry a "stigma" that would make them rare in offering due to the reputational risks they would carry in the marketplace. In the highly charged and volatile regulatory environment, post Dodd-Frank, we believe many lenders will not venture their Consumer Mortgage/Real Estate Lending outside the boundaries of QM.

Third, we are concerned that the proposed rule does not take into full account market realities in terms of pricing that are in effect today; especially as one considers the new 3% Points/Fees test that the Board proposes. The rule's construction of the ***Bona Fide Discount Points*** exemption is a major example of this fact. We believe the proposed 3% Points/Fees test is set so rigid that it may have the unintended consequence of creating a disparate impact on certain classes of borrowers by creating an inability to exempt discount points paid and thus it raises Fair Lending concerns. This arises from the fact that in conventional loan markets there are present today (since 2007) Loan Level Pricing Adjusters based on the Credit Score and Loan to Value of each loan which increase as the Credit Score decreases.

Furthermore the construction of the 3% Points/Fees test is such that includes lender compensation which creates further regulatory and compliance confusion as to how to properly structure compensation, which was just changed by the Board's final rule on April 1 of this year, around yet another regulatory hurdle. Furthermore, the Points and Fees test takes into account charges such as lender compensation, that were never included in HOEPA, the last major legislation that determined a definition of "high cost" loans.

Finally, as the proposed rule will apply to all mortgage loans made, we have concerns about a drawing back of lenders for vacation home and investment property markets. Again this is due to the concern that the ***Bona Fide Discount Points*** exemption uses an immovable benchmark of the Average Prime Offered Rate (APOR) that does not properly take into account the pricing differentials present in the market today for different occupancies that are made manifest in the Loan Level Pricing Adjusters mentioned above.

Endorsement of MBA-ABA Industry Proposed QM Safe Harbor

We would like to conclude our opening summary of remarks with an enthusiastic statement of support for the industry endorsed alternative that is being proposed by the Mortgage Bankers Association and American Bankers Association. Their proposed Safe Harbor QM not only incorporates many of the basic standards of the Board's QM Safe Harbor under the rule but would add to it in terms of requiring consideration ***AND*** verification of particular data fields and not consideration only.

We believe their proposal is one that fulfills both the requirements of Congressional intent to strengthen underwriting standards and prevent an evaporation of housing credit from the market that an overly burdensome and narrowly constructed rule will create. We would respectfully recommend the Board make a serious and detailed consideration of the proposal from MBA-ABA.

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Background & Market Presence of SpiritBank

SpiritBank is a state chartered Commercial Bank headquartered in Bristow, OK that has been in business since 1916. In the 95 years since her inception SpiritBank has grown to a size of $1.25 Billion in Assets putting her in the top 10% of banks in Oklahoma. Nonetheless, SpiritBank remains a Community Bank at her core and in her heart and through her daily mission.

Employing 485 Oklahomans in 13 branches located in 9 communities throughout the state, SpiritBank knows her roots and stresses daily the responsibilities we have to the depositors and borrowers in those communities where we operate and do business. After all, the first rule of good business be it in banking or any other industry, is to take care of your customer by working to help them achieve their needs as well as their dreams and aspirations. This is the very essence of what it means to be a "community bank". Furthermore, by taking care of your customers your customers will take care of your business. Community banks do not seek to set their customers out to fail. That violates the first rule and principle of sound business practice.

SpiritBank delivers residential mortgage finance to our markets through three distinct channels- Traditional Portfolio, Retail Mortgage and Secondary Platform.

First is our traditional portfolio lending channel of consumer lenders with our branch banks. We maintain approximately $36.3 Million in Consumer/Residential (1-4 Family and Manufactured Housing) assets in portfolio as of June 30, 2011. Many of these approximately 850 loans can be found in the several rural market areas we serve in our footprint which stretches from Tulsa in NE Oklahoma to Oklahoma City in the center of the state. Many of these loans are made on balloon type products or our 3 Year Portfolio ARM product. Most of these borrowers are looking at lower and moderately priced housing units as evidenced by the average loan size of $42,700 given the above data. As such many of these borrowers may view longer term (over 15 Years) fixed rate mortgages as being outside their need. They may also tend to prefer having a mortgage held locally at their community bank where they may walk in to the lobby or go through the drive thru to make their monthly housing payment.

SpiritBank's second channel is found in our relatively small yet robust retail residential mortgage lending department that lends primarily throughout Oklahoma and has averaged $180 Million in loan volume (approximately 1100-1200 loans per year) for the past 3 years. The past few years has seen a large amount of that volume in purchase transactions. This department lends based on traditional Conventional and Government Loan programs (Fannie Mae, Freddie Mac, FHA/VA/USDA's Rural Housing and HUD Native American 184 Programs) and presents those loans after closing to the secondary market for sale to larger servicers.

SpiriBank's reach in residential mortgage finance stretches further than her direct to consumer retail lending channels described above. SpiritBank is the parent company and 100% owner of American Southwest Mortgage Company (ASMC), a secondary market platform that originates residential mortgages through third party origination from other smaller community banks, independent mortgage companies and mortgage brokers. In the 24 month period of 2009 and 2010, ASMC funded over 23,000 loans in 34 states (2/3 of the nation) for a dollar volume of over $3.373 BILLION. Like our Retail lending, ASMC originates only traditional Agency and Government loan products.

The dollar volume alone of ASMC and SpiritBank Retail Mortgage makes SpiritBank one of the largest if not the largest residential home mortgage lender in the state of Oklahoma. The loans made through our Retail and ASMC channels are underwritten according to traditional Agency and Government loan programs which incorporate use of Automated Underwriting Systems (Fannie Mae Desktop Underwriter®, DU and Freddie Mac Loan Prospector®, LP) and those loans are presented to larger Seller/Servicers on a Correspondent Basis after the loans are fully underwritten and closed by our Retail and/or ASMC department personnel.

SpiritBank, through all her channels, underwrites based upon traditionally accepted standards of verification and criteria supporting the concept of the borrower's ability to repay the loan. Much of the various criteria related to a borrower's ability to repay that are traditionally taken into account include the following as may be applicable to a specific loan request:

1. Borrower's Verifiable Income
2. Borrower's Employment History & Status
3. Borrower's Credit History—"Do they pay their current creditors as agreed?"
4. Borrower's Housing Payment History—"Did they pay rent and/or previous mortgages as agreed?"
5. Borrower's liquid financial assets for down payment, closing costs and reserves (Reserves are funds remaining after the transaction—essentially liquid savings or cash)
6. Borrower's source of down payment, closing costs, etc—"Does the borrower have a stake or investment in the transaction?"
7. Borrower's "Housing Payment Shock"—what is the relative size of the new proposed housing payment to the Borrower's current housing payment?
8. Borrower's Residual Income
9. Borrower's Housing to Income Ratio (aka "Front" or "Housing" Ratio)
10. Borrower's Total Debt to Income Ratio (aka "Back Ratio" or "Total DTI%)

Traditional underwriting standards such as the above require the borrower's to provide to us various documentation that is analyzed and reviewed by underwriting to ascertain ability and factual integrity and validity of the data provided. Various forms of documentation that are obtained are based upon government and industry accepted standards and include many of the following as a specific loan request may require:

1. Previous 2 years Federal Income Tax Returns (Filed/Signed Copies)
2. Previous 2 years Federal Income Tax Return Transcripts (to validate tax returns)
3. Paystubs from within the past 30 days prior to closing of a loan
4. W2's for past 2 years (and in some cases independent verification via a W2 Transcript which is similar to a Tax Return Transcript- again to validate data and verify integrity of data)
5. Verbal Verification of Employment
6. Written Verification of Employment

7. Corporate Tax Returns/Business Tax Returns for Self-Employed Borrowers
8. Letters from CPA/Tax Preparer/Accountant for Self-Employed Borrowers
9. Current and up to date, unexpired Licenses and/or Professional Industry Memberships for Self-Employed Borrowers (Bar Membership for Attorneys for example or Medical Board Registration for Doctors)
10. Copies of Bank Statements/Asset Account Statements to verify liquid assets
11. Verification of Deposits to corroborate Account Statements for asset verification
12. Copy of Credit Bureau to verify credit performance—"do they pay as agreed?"
13. Verification of Mortgage or Rent to verify Housing Payment Performance and Housing Payment Shock
14. Analysis of Income Documentation obtained for proper calculation of Borrower's Qualifying Gross Income
15. Standards and adherence to compensating factors when Total DTI% moves outside pre-established "comfort zones"—including "Residual Income Tests", "Consideration of Non-Obligated Occupants income" that is not being included in overall Debt to Income Ratios

SpiritBank maintains a standard of determining whether or not a borrower can truly afford to repay their loan by means of the above objective standards and verifications. Such is our standard from both a safety and soundness standpoint but also from one of making sure that we are not setting our customers up for failure; that would violate the first principle in any community bank's mission.

Recently, a mortgage loan was declined in our Retail lending department despite the presence of an Automated Underwriting Approval. The credit denial for the loan amount requested was based upon an overly high Debt to Income ratio that exceeded 50% of the borrower's gross income. The credit denial came after an in-depth review of the borrower's residual income which showed a paltry amount left over monthly after creditor payments, including the new proposed mortgage, for basic necessities.

It was and is more responsible to deny that loan request and counsel the consumer to find something more affordable or work to pay down other debt before putting them into a situation where they will be stretched to the limit and thus only one financial stumble away from being another delinquency statistic on the road to foreclosure and future credit problems.

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Background of the Rule and Title 14 of Dodd-Frank Act

In the creation of Title XIV of Dodd-Frank, the ***"Mortgage Reform and Anti-Predatory Lending Act,"*** Congress sought to establish certain basic underwriting criteria and origination standards for all residential mortgage loans made. These minimum standards are intended to raise the quality of lending in housing finance markets as well as seek to remove certain products from the marketplace by government fiat.

One only needs to turn to the quote from Maureen Yap, Senior Attorney with the Federal Reserve in the Division of Consumer and Community Affairs in the May 26, 2011 call held by the FRB of San Francisco on the ATR Rule. In regards to the provision under the General Ability to Repay standard the consideration and verification of "Income or Assets (other than the house)" Ms. Yap said:

"This provision essentially means that creditors can no longer originate No or Low documentation loans. The income or assets relied on to qualify the consumer must be verified and documented."[3]

When one looks back to the lending boom of the 2004-2007 timeframe one sees an marked increase in loans in the "Alt-a" and "Subprime" product channels in private-label Residential Mortgage Backed Securities (RMBS). "Alt-a" means loans to generally good credit borrowers where there was applied a limited review of the income and/or assets of the borrower as opposed to a Prime or "A" borrower where there is a full documentation of income/assets and thus a fuller consideration and verification of that borrower's (the "A" borrower) general ability to repay. Subprime of course refers to those borrowers with lower credit scores and credit blemishes that could not obtain financing for a prime or "A" borrower loan.

According to Mark Zandi and Cristin deRitis of Moody's Analytics, Alt-a, Subprime and Option ARM (Negative Amortization loans) accounted for 27%, 40% and 13% of private-label RMBS originations in 2007. Zandi further states that "stated-documentation" loans made up almost 50% of all mortgages in these private-label RMBS during 2007[4]. According to a study by Mortgage Insurance provider, MGIC, loans with these attributes such as Negative Amortization, Reduced Documentation and/or Subprime credit raised the incremental risk of foreclosure by several times; specifically 3-4 times for Negative Amortization, 3 times for Reduced documentation and 2-3 times for Subprime Credit[5].

In light of such loose underwriting standards it is evident as to why Congress believed it had to work to develop protections to the nation's housing finance system via Title XIV. When Wall

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[3] Source Maureen Yap, Sr. Attorney at the FRB. Can be found at Outlook Live or at the following link http://www.visualwebcaster.com/FederalReserveBankSF/79706/event.html

[4] Mark Zandi and Cristin deRitis of Moody's Analytics in their Special Report "The Future of the Mortgage Finance System" February 7, 2011 can be found at http://www.moodysanalytics.com/~/media/Homepage/Insights/February-2011/Mortgage-Finance-Reform-0207111.ashx

[5] As referenced in Moody's Analytics Special Report, "The Skinny on Skin in the Game" March 11, 2011 by Mark Zandi and Cristin deRitis and can be found at http://www.moodysanalytics.com/~/media/Insight/Economic-Analysis/Special-Studies/03-11-11-The-Skinny-on-Skin-in-the-Game.ashx

Street's Investment Houses began their financial innovations the layering of risk was perpetuated and amplified. From that we saw the combining of such varied risky features (Low or No Documentation loans with Negative Amortization to Lower end credit score borrowers) that created the most toxic of mortgages that only served to compound the credit meltdown.

However, the overwhelming majority of community banks avoided such excesses. Many did not engage in the riskiest of lending as evidenced by the fact they remain in business today.

We believe it is clear that while Congress wanted to prevent a return to the days of relaxed lending standards where no consideration or verifications were made of a borrower's ATR we also believe it is evident from the statutory language of Section 1412 that the Congress is also granting the Board the ability to tailor the QM Legal Safe Harbor so that credit is not unduly constricted or hampered.

We again encourage the Board to use that discretion in tailoring a final rule that will satisfy the intent of Title XIV while at the same time not impose an arbitrary uncertainty of risk into credit markets.

Commentary Addressing Specific Requests by the Board

The Board asks for various comments on several areas of the proposed rule and we would like to take the opportunity to provide the feedback we believe is relevant and hopefully directive to provide the correct guidance to the Board as a Community Bank lender actively engaged in the business of providing residential mortgage finance in the markets we serve. We believe the Board is sincere in their seeking to strike the Congressional mandated balance that is found in Section 1412 of Dodd-Frank.

QM—Alternative 1 or Alternative 2?

The Board presents two Alternatives for the QM. Alternative 1 is a Legal Safe Harbor and Alternative 2 is a Rebuttable Presumption of Compliance. Given the current uncertainties in the marketplace that have been created by various legislative and regulatory initiatives enacted over the past 3 years, it is a safe assumption that many lenders will naturally position themselves to want to lend exclusively from a Safe Harbor Position in terms of the types of loans they originate. In response to the Board's question on which Alternative for the QM should be adopted, Legal Safe Harbor or Rebuttable Presumption of Compliance we believe that the Legal Safe Harbor best assures that the goals of Title XIV are met. We would encourage and urge the Board to adopt Alternative 1, the Legal Safe Harbor, as the basic legal protection of the Qualified Mortgage.

Only with a legal safe harbor can lenders be assured that partial, opinionated and arbitrary judicial discretion will not create a patchwork of legal precedents and cases arising should Alternative 2, Rebuttable Presumption of Compliance, be adopted. Rebuttable presumptions are "legal facades" at best that cannot provide the necessary protection to lenders who are making the good faith effort to reasonably determine the borrower's ATR at time of the loan's consummation. Due to the arbitrary nature of such defenses lenders will be more likely to draw back credit which brings us back to the basic conundrum that the Board faces in balancing these two strategic interests as imposed by Congress—implementation of meaningful ATR but with the caveat of not upsetting credit markets.

The economic impact of adopting Alternative 2 cannot be overstated. Were Alternative 2 to be adopted there is little doubt that the market would price in a new risk premium for all loans due to the uncertainty such a vague and opaque standard as Rebuttable Presumption will create. In many ways it is no different from the uncertainty that is created by authority for mortgage cramdown granted to judges in bankruptcy proceedings that has been debated at various times the past several years. With the Legal Safe Harbor market participants have a clearer and more transparent view of the legal risks associated with the originated mortgages and with more information there is a more efficient pricing within the market for credit.

Again, we would encourage the Board to adopt Alternative 1 of the Legal Safe Harbor with the following caveats and changes we suggest in following remarks. We again also reiterate our support for the Industry Proposed Safe Harbor proposed by the Mortgage Bankers Association and American Bankers Association as it makes the proper changes to actually strengthen the Safe Harbor from its current proposed form.

QM—3% Points & Fees Test

Both QM Alternatives have a Points and Fees test of 3% of the loan amount with a proposal to revise the definition of points and fees in Section 226.32(b) (1) of TILA. We believe that the Board must essentially "get this right" as the majority of lending will be QM concentrated. Failure to construct a test that is transparent, easy to comprehend and equitable will invariably lead to mass exodus of lenders from the mortgage lending space; especially community banks.

It is in this context that we believe the Points/Fees test as proposed by the Board is overly complex, confusing and contains within it the elements of a ***de facto price cap*** that raises a variety of concerns chief among them the following which we will expand on:

1. Fair Lending Concerns Related to the Fact of Credit Score Adjustments in Market Pricing when determining the exemption eligibility of a ***Bona Fide*** Discount Point;

2. Economic Concerns Related to the Impact of Rates and Credit availability on Second Homes and Investment Properties due to Loan Level Pricing Adjusters in the Marketplace for those products again in light of the ***Bona Fide*** Discount Point Test

3. Concerns related to credit availability for Jumbo Loans again in light of the ***Bona Fide*** Discount Point Test;

4. Concerns related to the inclusion of Lender Compensation and Private Mortgage Insurance Premiums into the overall definition of the 3% Points & Fees test;

Before addressing these areas of concern specifically we would make the point that the Board also asks for commentary on the Loan Size Formulas for smaller loans in the QM Exemption as to loans under $75,000. We believe the $75,000 is artificially low and given the increasing costs faced by lenders and other real estate related industries in a real estate transaction (title companies, appraisers, etc) we believe that a failure to raise the threshold for small loans would create an exodus of lenders from servicing those markets. Thus low to moderate income borrowers would have less choice and option when shopping for a home mortgage.

According to FHFA's Average Loan Size Data (Q2 2010 most recent available) the average loan size in the United States at the end of the 2nd Quarter of 2010 was $193,800.36[6]. We'd propose using an 80% variance on this which is $155,040 and would further round down to $150,000 for consideration of what will be a "small" loan size under the proposed rule so as not to crowd out credit for borrowers in these price markets.

Less credit availability due to lenders exiting the market can have an extremely detrimental impact on borrowers especially in low to moderate income areas. We'd further recommend that the Board, in addition to raising the threshold to $150,000, also propose changes to the sliding scale test for loans under the "small loan" threshold in order to assure that ample suppliers of

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[6] Federal Housing Finance Agency 2010 Q2 found at http://www.fhfa.gov/Default.aspx?Page=158

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credit remain within the residential mortgage space. Removal of profit motive through an overly onerous and abstruse Points & Fees test will only serve to remove actors from the market and thus concentrate greater lending market share in fewer lenders; which is antithetical to one of the stated goals of the Dodd-Frank Act itself, ending "too big to fail". We present the Title to the Act in its entirety with emphasis/highlight added to the pertinent section:

To promote the financial stability of the United States by improving accountability and transparency in the financial system, to end "too big to fail", to protect the American taxpayer by ending bailouts, to protect consumers from abusive financial services practices, and for other purposes.[7]

We recommend the Board consider an alternative sliding scale as the basis for establishing the Points & Fees Cap:

- 3.5% for loans from $125,000 to $149,999.99
- 4.0% for loans from $100,000 to $124,999.99
- 4.5% for loans from $75,0000 to $99,999.99
- 5.0% on all loans under $75,000

Critique of the Bona Fide Points Test and Concerns Raised

Section 1412, (2), (C), (ii) "Computation" of the Act calls for the determination of whether or not a discount point is "bona fide" in order to be exempted from the 3% Points and Fees test. While we do heartily support the exemption we have concerns as to whether or not the Board has fully taken into account current pricing structures in the market today (especially the secondary market) that may have the unintended consequence of shutting off credit to particular borrowers especially in the event borrowers in protected classes find themselves having access to less credit. The following commentary on Loan Level Pricing Adjustments is to address our concerns on first three points listed above on Page 12 related to the Board's construction of the Points & Fees test.

Loan Level Pricing Adjustments

Since 2007 prior to the more seismic shifts in credit markets that arrived in 2008, the market for conventional loans and in some cases government loans have moved to a risk based pricing matrix that takes into account a variety of metrics concerning each loan including:[8]

1. Credit Score
2. Loan to Value
3. Occupancy of Property (Owner/Primary; Vacation/2nd; or Investment/Non-Owner)
4. Number of Units (1 Unit through 4 Units)
5. Term of Mortgage (Greater than or less than 15 Years)
6. Purpose of Loan (Purchase, Rate/Term Refinance or Cash Out Refinance)

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[7] Dodd-Frank Act Main Title- Public Law 111-203 of the 111th Congress as found at http://www.gpo.gov/fdsys/pkg/PLAW-111publ203/pdf/PLAW-111publ203.pdf
[8] Source: Fannie Mae found at https://www.efanniemae.com/sf/refmaterials/llpa/pdf/llpamatrix.pdf

7. Property Type (Single Family Residence or Condominium)
8. Whether or not subordinate financing (second mortgage) exists

While we appreciate the fact the Board gives a very detailed explanation as to their analysis for not excluding Risk Based price adjustments in the Proposed Rule's commentary on Page 27466, we question whether the Board has taken into full account the possibilities that may exist, including Risk Based price adjustments for several different categories above outside of only Credit Score. Given the fact that once again the Board is forced into a "narrow channel" by the statute we believe it is on this specific subject where the Board's exercise of discretion would be most prudent as the formula proscribed has the potential to create more problems than it solves.

Specifically by establishing a formula for the allowed "exemption" of *bona fide* discount points, the Board is establishing a *de facto* price cap in the marketplace. Speaking from a secondary market standpoint, each investor has the potential to "overlay" their own underwriting requirements and price adjusters for particular loan metrics as well as a reflection of their own prudential risk management. If the Board determines that: 1. Only a particular amount of points may be considered *bona fide* even if the consumer in full disclosure wishes to pay more and 2. A brightline is established that would disqualify a loan from being a QM based on the inability to qualify for an exemption of certain discount points paid then the Board is indeed placing a price cap in the market by its imposition of a "cap" on the amount of points that may be exempted from the 3% test.

There are a variety of problems with this approach:

1. Price caps will always lead to shortages in a market driven by supply and demand due to the artificial nature of the price cap itself.

2. The Board, if it holds to the letter of the statute absent any exercise of discretion will essentially be setting a "conversion ratio" of how much a rate may be bought down by imposition of the APOR standard instead of allowing market forces to dictate such a conversion.

3. The QM's Point/Fees test applicability to Non Owner Occupied Homes (Investment/Rental) and Second Homes does not take into account the higher LLPA's for those loans. Using a rigid standard of a ratio of rate spread over the APOR, besides being confusing as it is once again another test (along with HOEPA, HPML, MDIA, etc) with which a lender must comply, does not allow for flexibility in making sure credit is available for qualified borrowers purchasing Non-Owner Occupied and Vacation Homes which will carry higher price adjusters in the market for the risk associated with the occupancy.

4. The Board's approach also does not take into account the fact that some lenders may not have or offer a Zero Points Rate on a particular loan due to a variety of factors that impact the overall rate/price that is offered—particularly from a Secondary Market perspective of pricing.

5. The same inflexibility of the Board's standard above also does not work for Jumbo loans that are priced higher in the market to begin with as they are not backed by government guarantee as are Fannie/Freddie and FHA/VA/USDA loan programs.

6. Furthermore, by proscribing an actual benchmark by which a discount point may be considered *bona fide* and thus exempt the Board is ***contradicting itself*** later in the Rule (Page 27467) where it states that the discount point must also be ***"consistent with established industry practices for determining the amount of reduction in the interest rate"*** and ***"accounts for an amount of compensation that the creditor can reasonably expect to receive from the secondary market investors in return for the mortgage loan"***[9] If the Board, in the language of the Act, is asking lenders on one hand to rest on "established industry practice" but is yet proscribing a formula ***with a starting point*** by which a discount point is *bona fide* then the Board must realize the fact that our position that this is a ***de facto price cap***, no different than that in the Durbin Amendment on Interchange Fees, is indeed a valid argument.

The concern we have is that particular segments of the market may find credit less available due to the very complex way in which statutory language of Section 1412, (2), (C), (ii) "Computation" forces the Board to construct the Points/Fees test and the definition it uses to exempt *bona fide* discount points. Borrowers with a lower credit score, who nonetheless present an acceptable and prudent credit risk when the entire borrower credit profile is reviewed *in totum*, may find themselves cut off from affordable housing credit options.

Furthermore we have concerns that the inability to exempt discount points for borrowers with lower credit scores, especially if any borrower is in a protected class as defined by ECOA and Fair Lending laws could create further regulatory, legal and compliance issues for lenders. If a lender finds that they cannot offer rates below a particular credit score due to the Risk Based Pricing adjusters that exist then will that lender be facing accusations of disparate impact under Fair Lending law should there be protected class borrowers who cannot meet the Points & Fees test of the QM?

We'd remind the Board that in their August 2007 study presented to the Congress as mandated by Section 215 of the Fair and Accurate Credit Transactions Act of 2003 that the Board concluded on page 8 that there are differences in credit scores among populations and different communities. The Board states in the report that some protected classes including differences based on race, age, gender and location (low-income census tracts) had lower credit scores than other subpopulations defined by race, ethnicity, age, location or marital status.[10]

Our overriding concern is that should the Board have determined in the 2007 study that a pattern exists in credit scoring among different subpopulations some of which are protected classes, then the Board has a duty to not create a structure where lenders may exit the marketplace for

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[9] 12 CFR Part 226, May 11, 2011 RIN 7100-AD75 found at http://www.gpo.gov/fdsys/pkg/FR-2011-05-11/pdf/2011-9766.pdf

[10] FRB "Report to the Congress on Credit Scoring and Its Effects on the Availability and Affordability of Credit" submitted pursuant to Section 215 of the FACT Act of 2003 (FACTA). Found at http://www.federalreserve.gov/boarddocs/rptcongress/creditscore/creditscore.pdf

borrowers with less than perfect credit and potentially harm some of the subpopulations in protected classes by forcing them into potentially higher non-QM loans or shutting off all options altogether. Nor should the Board in the interest of preventing regulatory contradiction, create such a structure that would lead to the potential for lenders to violate unwittingly other federal law and mandates. Again, the use of discretion under Section 1412 would be appropriate to prevent a QM from being defined in such a way to create a greater potential for disparate impact.

In light of this we would strongly urge the Board to revisit the issue of how *bona fide* discount points are determined and not necessarily use an inflexible standard such as the APOR from which to determine the "starting point" that is allowed in order to exempt discount points from a transaction. We would recommend a much more flexible, market-based approach to determining discount points viability or not cap the amount of points a borrower may pay and thus have exempt.

The Board must also consider the impact to hard hit markets with a large number of vacation homes as vacation homes and non-owner occupied homes are subject to the QM rule. Not taking into account a thoughtful and balanced approach on the Risk Based LLPAs could have an unintended consequence of constricting credit flow for purchasers of Vacation Homes and Non-Owner Occupied properties and that would further exacerbate the problems in states with large vacation home markets.

Due to the LLPAs on Vacation and Non-Owner Occupied homes there is the potential many times for a rate with no points to be positioned well above the brightlines the statute creates and the Board imposes. Thus those discount points would not be exempt under the present proposed structure. With the concern that lenders will flow into the QM almost exclusively, there lies the potential for lending to contract in areas that need credit flowing to revive vacation home markets. Furthermore, a viable secondary market option is necessary for Non-Owner Occupied properties so that qualified borrowers may be able to purchase homes and revitalize blighted or foreclosed properties back into sustainable and marketable homes for renters. A QM that has in it such a rigid and inflexible Points & Fees test that does not recognize

Other examples such as relocations where a borrower's employer will pay 2 discount points typically as part of the relocation package can spring to mind. If a lender is unable, because of the "starting point" where they must begin to exempt both points then the borrower is ultimately the only party harmed.

Critique of Other Sections of the Points & Fees Test

We also believe there are concerns to be raised in Point # 4 on Page 11 in the inclusion of Lender Compensation and Private Mortgage Insurance in the 3% Points & Fees test to determine the QM.

Our concerns are that should both of these remain unchanged we believe there will be the further impact of constricting credit which again contradicts the Congressional mandate of Title XIV of DFA.

Lender Compensation

First on the topic of Lender Compensation; we appreciate the Board's burden that it finds itself facing within the language of Subtitle C, Section 1431 of the Act. However as we believe that language is forcing the Board to construct a rule in which Discount Points may or may not be exempted (see above) that the rule essentially "double counts" that by forcing compensation to the originator into the overall Points & Fees test.

The Board already addressed the issue of Originator Compensation in its Rule that took effect on April 1, 2011[11]. The Rule prohibits the payment of Originator Compensation based on terms or conditions of a loan and the Board executed it under its authority from TILA and HOEPA to protect consumers from unfair or abusive lending practices that may arise from Originator Compensation practices. That rule, by far one of the most sweeping of its kind, effectively established a policy that ends compensation tied to a borrower's interest rate or yield. This is a substantive change that many in community banking, ourselves included, support as a way to stop unfair and abusive lending practices. It creates for better incentive alignment and thus serves as a means to an end, that end being better underwriting and thus improved credit quality and performance which is in the consumer/borrower's best interest.

Included in terms and conditions is the implication that compensation cannot vary according to:

- Transaction type (Purchase versus Refinance)
- Program/Product (FHA versus Conventional)
- Occupancy (Principal Dwelling versus Vacation Home)
- State Housing Finance Loans versus "standard" market loans

Source: Outlook Live[12]

As with the other problems of the Points/Fees test being based on an inflexible standard there also remains a difficulty in counting the lender compensation besides the double counting of the points. The Board has made very clear that the issue of lender compensation is one that they believe must be included in the overall Points & Fees test. In essence however the Board must appreciate the issue that arises in counting compensation.

For example, our Retail Lending Department is not unlike many other Mortgage Departments of our kind in Community Banks both in Oklahoma and across the country when it comes to the payment of compensation to our Mortgage Loan Originators (MLOs). Our MLOs are paid based on the gross aggregate dollar volume of all loans produced during a month; regardless of individual loan amount, loan program, rate, and/or any other term or condition. As compensation is now a fixed cost (basis points) there cannot be any variation from it outside the

[11] 12 CFR Part 226; Regulation Z; Docket No.R-1366 found at http://edocket.access.gpo.gov/2010/pdf/2010-22161.pdf

[12] Outlook Live "Regulation Z—Loan Originator Compensation" Outlook Live Webinar, March 17, 2011 as presented by the FRB Division of Consumer and Community Affairs. Found at http://www.philadelphiafed.org/bank-resources/publications/consumer-compliance-outlook/outlook-live/2011/031711.pdf

guidance provided by the MLO Compensation rule in terms of when compensation may be renegotiated.

We can envision real examples where there would be issues of loans violating the QM 3% Points/Fees Test given the fact that LLPAs as mentioned above are included. Higher compensated MLOs (say at 0.95%) could find themselves boxed out of being able to offer their customers particular programs or products based on a 3% Points/Fees Cap—especially to borrowers who may have credit risk based adjustments or adjustments for property type where thus discount points are not considered *bona fide* as proposed by the Board. It also can create issues for Secondary Marketing managers who are attempting to keep pricing even and equal throughout the various markets they serve. Again, concerns arise over unintended mistakes and errors that could be interpreted by other Agencies and Regulators as violations of Fair Lending or Fair Housing and Equal Credit Opportunity laws all due to the complexity of this rule.

Furthermore, in that same line of thought, MLO compensation is allowed under the finalized rule to vary from MLO to MLO employed by the same creditor. Given that fact, the Board must appreciate that with so many lenders paying commission based on gross aggregate volume that a disparity is created in pricing of different loans that would necessitate a lender to adopt a single standard of compensation. In essence, the Points/Fees Test as proposed throws considerable weight behind the argument that smaller lenders, especially community banks that compete for quality MLOs will be most harmed in the sense that they have a limited ability to offer varied compensation for quality MLOs.

By that we mean that in order for a lender to maintain compliance with Fair Lending they could not allow MLOs in the same market to have different rates with differing pricing. Yet in essence the Board is forcing that very standard by forcing a one size fits all approach on the Points & Fees Test with lenders who are allowed by yet another Board rule under TILA to allow variations in MLO compensation plans between MLOs. The structure of the rule in allowing lender compensation to count is also dangerous as it essentially forces lenders to do away with the ability to “tier” aggregate volume for compensation.

For example, an MLO may earn 0.50% on the first $500,000 in total aggregate loan volume they close and at $500,001 they increase to 0.65% on the entire amount (back to the first dollar originated so as to be in compliance with the MLO Compensation Rule). If a loan has already closed that was close to the 3% Max Cap there can be an inadvertent breaking of that cap by the MLO’s increase in volume and thus compensation and that could prevent the loan from being sold into the secondary market should an investor refuse to buy Non-QM loans. Nor does the lender have the ability to go back (under the TILA MLO Compensation Rule) and lower the MLO’s compensation to assure compliance with the QM Points and Fees Cap—that would be a violation of TILA as well. It is the classic “Catch-22” dilemma in play—which section of TILA does the Lender choose to violate?

Finally the Board’s proposal to exempt salary and loan compensation based on loan quality is inadequate at best as it is difficult to state what benchmark standard an examiner will use to consider a compensation policy based on “quality” to be in line and in compliance with this Rule given the broad vagaries of the term itself. We reiterate our urging to the Board to strongly reconsider the impacts that the Points & Fees test will have vis a vis the arguments we have proposed and to remove or re-work the test so as not to create the potential to put Lenders in a position to violate other regulations nor drive them from the marketplace due to a price cap that creates an inability to compete.

Private Mortgage Insurance

The final section we wish to address on the Points & Fees Test is the Board's consideration of Private Mortgage Insurance in the calculation of the 3% total Points/Fees for the determination of whether or not a loan is a QM. Once again we cannot overstate that we appreciate the Board's mandate but again we believe the exercise of discretion is necessary.

On Page 27401 of the proposed Rule the Board gives its reasoning behind their calculation of whether or not Private Mortgage Insurance Premiums should be considered and we'd strongly suggest the Board give thought to the fact once again of the impact this will have in the offering of products and programs to consumers.

The problems with the Board's analysis lie in two main points:

1. Failure to take into account the innovation in Mortgage Insurance products these past few years; namely Lender Paid Mortgage Insurance.

2. Mandating a Borrower Paid Single Premium Policy be "refundable" will result in a higher present value cost to the consumer today as opposed to a non-refundable policy.

First with the issue of Lender Paid MI or "LPMI" for short—LPMI is a product created in which the Lender Remits a single premium to an MI company for the payment of MI coverage in lieu of the borrower making the traditional monthly MI payments[13]. The borrower can elect to take a slightly higher interest rate in which the lender obtains more for the loan (if sold into Secondary Market) and uses that additional income to pay for the policy or the borrower may also be given the option to pay the cost in discount points to essentially buyout the cost of monthly mortgage insurance.

However the definition again of *bona fide* discount points comes into conflict with the ability to offer this product that saves the borrower on the monthly payment and still provides the necessary first loss coverage required on conventional loans with an LTV over 80%. Unless the issue is revisited this will have a negative impact on choice and options for consumers.

On the issue of a Borrower Paid Single Premium MI Policy the Board is stating on Page 27401 that the amount of a Borrower Paid Single Premium MI Policy may have a portion exempted from the Points & Fees test if the policy is refundable on a pro-rata basis and automatically issued upon notification of the satisfaction of the underlying mortgage loan. The Board gives the example of a policy for $3000 meeting just that requirement where the maximum allowable under the National Housing Act (i.e. "FHA) is $2000. In this case the first $2000 is exempted

[13] Radian Mortgage Insurance—See http://www.radian.biz/page?name=MIproducts

from the Points and Fees test. However if the policy is non-refundable then the entire $3000 is counted towards the Points & Fees test.

There are several problems with the approach the Board is suggesting.

First, the fact is that Refundable MI Premiums will cost the borrower more in present value terms as opposed to a non-refundable policy. For illustrative purposes we went to 4 of the 6 major Private Mortgage Insurance companies and ran the same scenario:

Purchase; Primary Residence/Owner Occupied; 1 Unit Single Family Residence; Total Debt to Income Ratio of 41%; Loan to Value of 95%; FICO of 740

We submitted under Borrower Paid Single Premium Policies that were both Refundable and Non-Refundable.

The difference between the Refundable Policies and Non-Refundable Policies were that the Refundable options were anywhere from 0.305% more expensive to as much as 0.90% more expensive.

While we appreciate the Board's diligence in providing for consumer protection in terms of the Borrower obtaining a refundable policy on the MI, there is a peculiarity as to how the consumer is benefited by having to take a policy that is more expensive in "real" terms (i.e. Present Value dollars) especially if they were to qualify only for the policy at one of the higher cost providers of the Mortgage Insurance.

Finally, the FHA Up Front Premium is currently at 1.00% meaning if the borrower in our example above took a refundable policy from the best provider they would still be facing roughly 2.05% in PMI costs that would be assessed against the 3%. Should they have their loan originated by an MLO at 0.75% compensation with the potential that the MLO goes to 1.00% then there's the potential for a breaching of the Points/Fees Cap.

We'd strongly urge the Board to re-work the approach to the Mortgage Insurance premium and we'd strongly suggest removing as an input and variable in the Points and Fees test.

Summarization

To summarize we would again stress our sincere opinion that the Board has a unique and unquestionable opportunity to construct a rule that is fair and equitable to consumers and does not have the counterintuitive effect of harming consumers by limiting their credit options and choices. This can best be realized by the following recommendations that we would respectfully submit to the Board for consideration on how to best improve and balance the competing interests of implementing ATR and maintaining credit market stability so as to avoid impeding economic recovery that would be harmed by further instability in housing and real estate markets in the United States:

1. Adoption of Alternative 1 which provides a Legal Safe Harbor Protection in the QM

2. Adoption of the Small Loan definition we propose above of $150,000 and below with the sliding scale also proposed above on Page 12

3. A meaningful revision of the 3% Points & Fees test as a determinant to the QM per the discretion granted the Board in Section 1412

   In conjunction with # 3:

- Flexibility in the Definition of *bona fide* discount points that allows for variations and market realities relating to Risk Based/Credit Score based pricing and Loan Level Pricing Adjusters that impact the "starting point" for different borrowers which raises Fair Lending Concerns
- Flexibility in the same definition for Jumbo loans again realizing the market realities present in credit markets for Jumbo loans
- The nullification of any requirement to subject loans on Vacation/Second & Non-Owner Occupied properties to any Points & Fees test in order to be in the QM Safe Harbor
- The striking of Lender Compensation as a factor in the formula of the Points/Fees test due to the double counting and legal complexities it presents in light of the Board's Final rule under TILA related to Lender Compensation that was just implemented April 1 of 2011
- The striking or Mortgage Insurance Premiums as a factor in the formula of the Points/Fees test due to the consumer harm that arises from creating a structure that would only cost the borrower more in "present value" terms by forcing them into a higher refundable MI policy in order to get into the QM Safe Harbor.

4. We strongly encourage the Board to review and adopt the QM Safe Harbor Standards proposed by the MBA-ABA which incorporate some of the necessary changes we recommend but also build upon and ***strengthen*** the QM from the standpoint of verification of data as opposed to "consideration" only.

Again at the risk of sounding like the proverbial "broken record" we would once again stress and emphasize and encourage the Board to exercise its duties and responsibilities of discretion in Section 1412 of the Act so as to balance out the benefits of the rule from the many potential harms that the statute has created.

Concluding Remarks

In conclusion we again wish to express our appreciation to offer these comments and feedback on the proposed rule for a borrower's "ability to repay" as mandated by Title XIV of the Dodd-Frank Act.

We would strongly urge the Board and the Consumer Financial Protection Bureau who will finalize this rule to take into consideration the points we have raised so as to assure that the Congressional mandates of consumer protection and consumer access to credit are both met in balance.

The word "credit" is derived from the Latin "*credere*" which means basically, "to believe". Inherent to the concept of belief is trust, that basic principle common to human beings regardless of race, gender, nationality or culture; which says that one may have a certain level of assurance essentially in the promises of another. The foundation of banking, especially community banking is about that very same concept- trust. It is about the trust that our customers put in us and we in them. The very notion of basic banking- depositing and lending alike- is about trust.

So it is no surprise that credit ought to be about basic trust; specifically that a borrower may trust the terms that a lender gives them in a loan transaction and for the lender that they may trust the borrower to repay according to those same terms.

It is unfortunate that it takes legislation and a rule of such length to codify what would be common sense to most persons. Again, we realize that the Board is acting in accordance with the Act and we encourage them to use their unique discretion and authority to improve upon the basic fundamental of credit—the determination of a borrower's ability to repay a loan.

We look forward to the finalization of the rule and if we may be of any further assistance or to contact us you may reach us at the number and/or email address below.

I remain—

Cordially,

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